



Canada's Stock Market Is Due for a Crash

Description

The **S&P/TSX Composite Index** is a roller coaster. In March, Canada's stock market sank by 40%. Since then, stocks have rocketed higher, regaining their former heights.

Just don't get too comfortable. Markets around the world are trading at crazy valuations.

Stock markets are scary

"The current P/E on the U.S. market is in the top 10% of its history," noted market strategist Jeremy Grantham. "The U.S. economy in contrast is in its worst 10%, perhaps even the worst 1%."

Canada is in a similar position. Stocks trade near all-time highs, yet the underlying economy is in shambles. Conditions are ripe for disaster.

"The market's P/E level typically reflects current conditions. Markets have historically loved fat margins, low inflation, stability and, by inference, low levels of uncertainty," Grantham continued. "This is apparently one of the most impressive mismatches in history. This is a new type of crisis and much will be different."

Warren Buffett always says that price is what you pay and value is what you get. If you look at the mismatch between stock prices and the economy that supports them, you'll see it's a scary time to be invested.

Canada is vulnerable

The Canadian economy is arguably more at risk than the United States. The problem is at the root of its economic engine.

The S&P/TSX Composite Index is perhaps the best gauge of how Canada's stock market is performing. It's also a loose proxy for which industries drive the economy.

Financials represent 30% of the index, with mining, energy, and industrials combining for another 40%. This means that roughly 70% of Canada's stock market is extremely vulnerable to economic shifts, particularly when compared to more resilient industries like tech, utilities, consumer staples, and healthcare.

The weighting of Canada's economy, and thus its stock market, should create worry. Just look at **Exxon**. Long lauded as a blue-chip stock, it was [officially removed](#) from the **Dow Jones Industrial Average** after a 92-year run.

Regulatory pressure is rising against oil companies. That's raising costs and reducing demand, a direct blow to Canadian producers like **Suncor**, **Imperial Oil**, and **Canadian Natural Resources**.

Additionally, huge banks like **Bank of Nova Scotia** and **Royal Bank of Canada** are at increased risk due to the pandemic. These institutions already lend heavily to the energy sector, which, as mentioned, faces long-term headwinds. Banks are also directly exposed to the real estate market, which could be in [bubble territory](#).

Take action

Canada has always had a higher-risk economy, based largely on resource extraction and financial lending. In uncertain times, this is not a stable position to be in.

No one knows the future, but we can assess market risk and take action. As Grantham advised, "There are no certainties but there are probably still some better and safer themes. Caution and patience are likely to be two of them."

Volatility will continue to be the norm. We are truly in unprecedented times. With several core weaknesses, Canada looks to have a rough finish to the year, with a potential rocky 2021 ahead of us. Caution is key.

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1. NYSE:BNS (The Bank of Nova Scotia)
2. NYSE:CNQ (Canadian Natural Resources)

3. NYSE:RY (Royal Bank of Canada)
4. NYSE:SU (Suncor Energy Inc.)
5. NYSEMKT:IMO (Imperial Oil Limited)
6. TSX:BNS (Bank Of Nova Scotia)
7. TSX:CNQ (Canadian Natural Resources Limited)
8. TSX:IMO (Imperial Oil Limited)
9. TSX:RY (Royal Bank of Canada)

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